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THE CROSS-COUNTRY EFFECTS OF POLITICAL RISK IN FOREIGN DIRECT INVESTMENT INFLOWS

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Abstract

With the rapid development of economic integration throughout the world, arguably one of the most important aspects of this trend is the surge of foreign direct investment - long-term and strategic in nature - made by multinational companies in foreign markets. Due to the rise of political polarization across the globe, studying the effects of political risk in foreign direct investment has been of great interest, not only among academics, but also among policy makers and governmental bodies. We find that higher political risk, translated into higher expropriation and transfer risk is associated with lower foreign direct investment inflows.

Keywords

Foreign Direct Investment, Democracy, Globalization, Political Risk

Introduction

The study of political risk as a determinant of foreign direct investment (FDI hereby) has been widely explored throughout the literature. With rising political tensions across the world, an increase in the ambitions of authoritarian regimes, and a polarized geopolitical spectrum, this relationship has never been so relevant as it is today.

According to Butler and Joaquin, 1998, political risk can be simply described as to what extend the "rules of the game" can unexpectedly change, a behaviour increasingly reoccurring not only in developing countries, for instance, in China under Xi Jinping, but also in developed ones like the United States of America (U.S. hereby) under Donald Trump.

Regarding the study of this relationship, the literature often focuses on host country characteristics (see, for example, Blonigne & Piger, 2014, for an extensive list of host country determinants), leaving neighbouring countries' characteristics unexamined. This paper intends to fill this research gap by also exploring the effects of neighbouring political risk in the host's attractiveness regarding FDI inflows.

By doing so, a better scholarly understanding can be achieved regarding the study of FDI location determinants, a key relationship in today's intricate and dynamic global economy. Therefore, the central objective of this dissertation is to explore how not only host political risk affects its attractiveness towards FDI, but also the one of its neighbours. To explore this relationship, a quantitative empirical approach design has been adopted, answering the following sub-questions:

i. What is the relationship between host political risk levels and host FDI inflows?
ii. How can the relationship between the hosts' closest geographical countries' political risk levels and host's FDI inflows be described?
iii. How can the relationship between the hosts' closest economic countries' political risk levels and host's FDI inflows be described?

Literature Review

1. Understanding Political Risk as a Determinant of FDI Inflows

It is possible to broadly divide the literature regarding the study of the relationship between host country political risk and host FDI inflows in two separate categories. In the first one, authors looked at a specific component of conceptualized multidimensional political risk structure and studied its relationship with host FDI inflows.

1.1. Political Risk Components

1.1.1. Democracy

Asiedu and Lien (2011) study the impact of host democracy in host FDI inflows and find a positive relationship between the two until a certain arbitrary point where the host country can be classified as a natural resources' exporter. The authors find that after this arbitrary level, being the host country a natural resource's exporter, higher levels of democracy have a negative impact on FDI inflows. This argument in supported by Li and Resnick (2003) which find empirical evidence that while an increase in democracy levels is key to produce a healthy, efficient and fair judicial system which imposes equal and fair property rights and patent protection for both multinational and national firms, after a certain threshold, depending on the idiosyncratic characteristics of the host nation, an increase in democracy could drive foreign investors away by imposing constraints on foreign capital and the host nation government.

1.1.2. Corruption

Wei (2000) highly regarded study on the determinants of FDI inflows across 45 host countries in the early 1990's has found empirical evidence that corruption had a statistically significant negative effect on FDI, a finding in accordance with Habib and Zurawicki (2002) which empirically show corruption as a significant obstacle to investment, specially to long-term foreign capital. The authors argue that both ethical and economic reasoning play a role in this

relationship, as not only foreign investors ethically disregard the fact of investing in a corrupt system but are also aware of the possible economic inefficiencies that it might carry.

1.1.3. Institution Quality

Henisz and Williamnson (1999) and Henisz (2000) stress that, if property rights are not well protected, FDI investors face two major risks. First, local competitors, due to better access to the political process, may persuade local governmental institutions to favour them at the expense of foreign investors (indirect hazard), and secondly, expropriation risk, where the host country may find it tempting to behave in an opportunistic way and appropriate the assets of foreign investors in order to retain some or all of its returns for themselves. This argument is supported by Vernon's (1971) theory of "obsolescing bargaining" that formulates that after a multinational has invested in a foreign country, it becomes fully exposed to opportunistic policy changes originated by the host government, which therefore, makes the initial "contract" the firm has signed obsolete. On the other side, Jun and Singh (1996) and Harms and Upsprung (2002) fail to identify any significant impact of institutions on FDI, a point from which Ali et al. (2010) picks upon, arguing the authors lack of adequate data both in quantity and quality is the main driver for this conclusion. Ali et al. (2010) in their seminal paper regarding this relationship, covering 69 developing countries during 1981 to 2005 find that institutional quality regarding investor protection exerts a significant role in determining the location of FDI inflows, going on to interpolate that this relationship materializes as property rights security is a key factor that both multinational companies and investors take into account when expanding to foreign markets.

1.2. Political Risk Indexes

The second strand of literature regarding the study of the effects of political risk in FDI inflows utilizes a political risk index, aggregated in one or several subcomponents in order to account for its intricate and multifaceted nature.

One of the first authors to accomplish such a task was Edward (1990), who utilized the political instability index built by Cukerman et al. (1989) to study host FDI attractiveness when host political instability levels increased. The index is based on the probability that the government of a given country changes for a given year, taking in account other destabilizing political variables like the amount of political violence acts during the given year, the number of political assassinations and politically motivated strikes. Edward (1990) concludes that, controlling for economic variables, an increase in political risk and instability leads to a decrease in FDI inflows in a given country, all else being equal.

Arguably the most used political index as a proxy to political risk in the literature comes from the International Country Risk Guide (ICRG), created and maintained by the PRS Group, which comprises 12 political risk subcomponents.

By utilizing several political risk subcomponents in their empirical models, authors have managed to expand the scope of their findings. Busse and Hefeker (2007), find empirical evidence that particular political risk subcomponents, namely, government stability, internal and external conflicts, law and order, and bureaucratic quality matter the most when multinational firms confront decisions regarding the location of their foreign expansion.

More recently, new indicators have been analysed in order to proxy for political risk. Most notability, Jensen (2008), a prominent author in the literature, with an effort to circumvent the qualitative aspect of measuring political risk, deploys insurance data as a quantitative measurement to act as its proxy. The insurance market for multinational firms and investors looking to invest abroad is rapidly expanding (Hansen, 2004), including not only private

insurers like Zurich, Lloyd's of London, Aon, AIG, but also public ones like the World Bank's Multinational Investment Guarantee Agency (MIGA) and the U.S Government's Overseas Private Investment Corporation (OPIC). Alone, MIGA helped to facilitate more than $36 billion in FDI to some of the highest risk countries, issuing guarantees totalling $7.1 billion between 1990 to 2000 (West and Tarazona, 2001). Although private insurers, which make up the majority part of the market, do not make public any pricing information regarding their products, it is possible to utilize insurance data from public entities like MIGA and OPIC, or go one level deeper and utilize the country risk ratings built by credit agencies, widely used public and private insurers alike to price their products.

2. *Understanding Neighbouring Political Risk as a Determinant of FDI Inflows*

Even though the literature regarding the relationship between political risk and FDI inflows focuses extensively on the host country as opposed to its geographic or economic neighbours, the latter has seen recent growing interest (Pinal and Stengos, 2020).

Kelejian et al. (2013) finds a spill over effect of governmental institutional quality between geographical neighbouring countries, a view supported by Ward and Dorussen (2015).

Easter and Levine (2000) empirically show that if the economic performance of the geographical neighbours of a given country is prominent and stable, then, it is more likely that that given country also faces the same economic prominent faith, being the opposite also true. Building on that idea, Bosket and Garretsen (2009) empirically show that determining long-term economic development of a given country does not only depend on its own institutions, but also the ones of its neighbouring partners.

A second channel in which neighbours can affect the economic outlook of a given country is through the spill over of political unrest or instability. Ades and Chua (1997) find that when political risk in the neighbouring geographical bloc of a given country increases, its expenditure

in education and trade decreases, while spending in national security increases, resulting in a decrease in economic developed and economic growth[1].

All in all, regarding the positive economic and political spillover effect on economic development between geographical countries seems to be an agreement point in the relevant literature.

The same agreement appears in the role of transnational violent acts like politically originated terrorism. For instance, Filer and Stanišić (2016), among others[2] find evidence that violent incidents, motivated by political reasons, or not, lead to a decrease in FDI flows to the host country, but also to its neighbours.

Adding to the existing literature, more recently, Pinar and Stengos (2020) find that countries that are democratic, surrounded by democratic neighbours, receive higher FDI inflows than democratic countries surrounded by non-democratic and unstable regimes. The authors also explore the contamination of good institutional governance in a geographical bloc and support the view of Kelejian et al. (2013) finding that countries surrounded by neighbours that have better institutions tend to see their own institutions shift towards this higher level of operational quality and efficiency, hinting to a complementary mechanism that positively affects FDI inflows.

Data

On top of the measurement issues that arise when quantifying political risk, other questions need to be addressed in order to allow us to build a proper model to study the relationship between host and neighbouring political risk, and host FDI attractiveness. These questions are explored below.

[1] See also Qureshi (2013)
[2] See Bandyopadhyay, Sandler, and Younas (2014)

1. Measuring FDI attractiveness (dependent variable)

FDI attractiveness will be measured by annual FDI net inflows per capita for a given economy for two main reasons. First, annual FDI new inflows correspond to the difference between FDI inflows and FDI disinvestment in a given economy one given year. This allows us to study the net effect on FDI which is ultimately what we expect to analyse. Secondly, we utilize FDI net inflows per capita, as it allows us to take the relative country size into account.

The FDI net inflows per capita measured in current USD for a given country in a given year were obtained from the UNCTAD Balance of Payments database, comprising 183 countries from 1970 until 2020.

2. Measuring Political Risk

As vastly noted in the literature, there is no common theoretical model that allows researchers to quantify political risk – a multifaceted and vastly complex concept. Nevertheless, we have at our disposal a vast set of literature trying to quantify it from its subcomponents retrieving information and indicators from several different sources. We will follow the major strains of literature and employ two different measurements of quantifying political risk.

2.1.Democracy

Democracy has been a widely used proxy of political risk in the literature (see for example Jensen, 2006 and Pinar & Stengos, 2020), namely because it also encompasses multi-dimensional levels, from the way institutions are set up, to how economic interactions happen. Compared to measuring political risk, measuring democracy has taken much more attention in the last decades, which gives us room to handpick a measuring methodology that best suits our research needs. Therefore, we will utilize Polity IV Project's Polity 2 Democracy Index (Marshall and Gurr, 2018), updated annually with data from 1946 until 2018, comprising several aspects of democracy that are directly linked to the relationship between political risk and FDI inflows that we are studying.

The index ranges from -10 (fully autocracy) to 10 (fully democratic) and aggregates three different elements of democracy, key for our research questions. The three elements are:

a. The degree of formal institutional and regulatory presence allows both individual and collective enterprises to influence public policy.
b. The degree of presence of institutionalized veto players with the ability to block or change the course of public policy.
c. The degree of liberty to which allows both individual and collective enterprises to pursue economic activity.

Supported by Jensen (2008), we find these elements extremely relevant in the building of foreign investor trust and confidence in the host country, key to increasing its attractiveness towards FDI inflows. Therefore, we expect a positive relationship between the host democracy levels, and FDI inflows.

Following the literatures long-established agreement in the spill-over effect of economic, social and political ideologies, and the most recent empirical findings (Pinar and Stengos, 2020) that the characteristics of neighbouring countries is also a factor that foreign investor take into account when deciding the location of their foreign investment, we also expect a positive relationship between the host's neighbouring countries' democracy levels and the attractiveness of FDI inflows in the host country.

The Polity II Democracy Index database also includes the duration, in years, that a regime, either democratic or authoritarian has lasted. We will include this variable in our analysis, and we expect that higher regime duration translates into a decrease in political instability and risk. Therefore, in our analysis, we expect to see a positive relationship between host regime duration and host attractiveness towards FDI. The same positive relationship is expected regarding the hosts' neighbours.

2.2.Export Credit Rating Data

Jensen (2008) introduces the novel idea of utilizing insurance data from products focused towards foreign investment risks. Due to the rapid increase in the foreign investment insurance market in the last two decades, the underlying information used to price these products has therefore also increased. Nevertheless, the majority of players in this insurance market are private, hence holding this information confidential. Although not ideal, we turned into public export credit rating agencies, many of which publish non-confidential ratings and indicators regarding different types of risk, for individual countries, that pose a threat to foreign investment. This information is then used by, among others, insurance firms looking to improve the pricing and marking of their products, many of which are extremely specific, and tailor made to the client needs and the nation that will be hosting the foreign investment.

We managed to obtain access to these country ratings from the Belgium Export Credit Agency, a key player in the export credit risk ratings, which sees its data deployed in major investment firms like IBM Plane Location International. Although the data the agency provides is public, to obtain past country ratings, we had to contact it, after which the data was kindly shared.

The dataset contains annual country risk ratings, ranging from 1 (very low risk) to 7 (very high risk) and is available from 2002 until 2020. The Belgium Export Credit Agency provides country ratings for three types of investment risk:

a. War and Political Violence Risk: accesses the risk that foreign assets in the host country are damaged or destroyed due to conflicts that involve violence in the host country.
b. Expropriation and Breach of Contract Risk: accesses the risk that the ownership of foreign assets in the host country are unlawfully taken away from the foreign owner.
c. Transfer Risk: accesses the risk that foreign capital in the host country is not able to move inside it, nor out of it.

We expect all three host risk ratings to be negatively correlated with the host's attractiveness towards FDI inflows, as both multinational and investors, profit maximizing entities, all else equal, will move towards minimizing these risks.

Furthermore, we expect the same negative relationship to happen between the hosts' neighbouring countries' risk and host attractiveness towards FDI inflows.

3. Determining Host Neighbours

To our knowledge, a great section of the literature when dealing with the effects of the characteristics of the hosts' neighbouring countries in the host country itself, tackles exclusively geographical neighbours in their scope of study. In addition to including the geographical neighbours of the host country in our scope of analysis, we will also include the hosts' economic neighbours in our models with the objective of expanding the scope of our study.

3.1. Determining Geographical Neighbours

For the geographical neighbour determination methodology, we utilize CEPIIs' GeoDist Database (Mayor and Zignago, 2011) which calculates the distance between two countries a weighted average of distance with population, among each country's biggest populational agglomerates.

Nevertheless, we needed to control for country size in the sense that very small nations with respects to population do not possess the political or economic power to exercise the spill-over effect between nations that the literature heavily discusses. Therefore, we choose a rather arbitrary populational threshold of 3 million inhabitants below which the remove the country in question from arising into consideration when calculating the closest geographical neighbours for each individual country. An additional limitation of this approach is that we had to choose a specific year to retrieve the inhabitants' number for each country to build the

populational threshold, as to not have changing geographically neighbours across the timeframe of our study.

3.2.Determining Economic Neighbours

To determine the economic neighbours of each individual country in our dataset, we used country pair data regarding the value, in absolute terms, of their trade balance, and then sorted by biggest amount. We retrieved trade balance data from the IMF's Direction of Trade Statistics (DOTS).

4. Control Variables

By drawing on past literature and economic theory we deploy a set of control variables vastly studied among scholars who have reached a relative consensus about their relationship with FDI inflows. Below, and additionally in Table I, we present a detailed characterization of the control variables we will be utilizing.

4.1. Host GDP Per Capita

In order to control for the size of the host economy, host GDP per capita has been commonly used in the literature (see for example Chakrabarti, 2001, and Head and Ries, 2008). Following economic theory, bigger markets are often associated with bigger returns on investment (Busse and Hefeker (2007), therefore we include host GDP per capita as a control variable in both our econometric models.

We expect therefore that higher host GDP per capita is associated with higher host FDI inflows.

4.2. Host GDP Growth

Similarly, among several authors, host GDP growth has also been used as a determinant of FDI inflows (see for example di Giovanni, 2005 and Stein and Daude, 2007). Building on top of economic reasoning, the higher the host GDP growth, the more investment opportunities are present in its market. Hence, we decide to include it in our models as a control variable, and we expect it to be positively associated with higher FDI inflows.

4.3. Host GDP Deflator

Inflation has also been empirically shown to be a determinant of FDI inflows (Busse and Hefeker, 2007) namely when deployed as a proxy of host macroeconomic policy effectiveness. Good macroeconomic policies promote small budget and trade deficits, low inflation and low interest rates, which in turn reduced the risk premia for both domestic and foreign investors, hence attracting FDI inflows. We decide to employ host GDP deflator in our models, and we expect it to be negatively correlated with FDI inflows.

4.4. Population Growth

The effects of population on FDI inflows have been widely studied (see for example Eaton and Tamura, 1994), and its dynamics follow closely to the ones of host GDP growth in the context of our research, in the sense that it measures market growth, a beneficial aspect that profit-seeking multinational firms seek to explore. We include population growth in both our models, and we expect it to be positively associated with FDI inflows.

4.5. Trade to GDP

Trade to GDP has been deployed among scholars (see for example Busse and Hefeker, 2007) as a way to account for host trade openness. Nevertheless, conflicts between its relationship with FDI inflows have risen (Asiedu, 2002). On the one hand, horizontal FDI inflows may be attracted by higher trade barriers as a protectionist measure allowing the foreign investor to serve the host market without needed to import to it, gaining a competitive advantage, but on the other hand, vertical FDI is attracted to rather lower trade barriers as it characterized by being exporting-oriented investment.

We will include Trade to GDP as a control variable in our models, and following Chakrabarti (2001) empirical evidence, we expect a positive relationship between trade to GDP and FDI inflows.

5. Descriptive Statistics

The descriptive statistics of the employed variables are depicted below:

Variable	Observations	Mean	Standard Deviation	Min	Max
Log FDI per Capita	7 987	3,53	2,85	-14,03	15,11
Log GDP per Capita	8 979	7,99	1,67	3,10	12,15
GDP Growth	8 691	3,42	6,30	-64,05	149,97
GDP Deflator	8 672	32,59	432,18	-31,90	26765,86
Population Growth	10 816	1,65	1,68	-10,96	28,04
Trade to GDP	7 569	81,84	54,79	0,02	863,20
Log Host Democracy	7 283	1,78	0,65	0	2,30
Host Regime Duration	16 310	20,92	24,59	0	170,00
Log Geo Democracy	6 809	1,54	0,84	-1,61	2,30
Geo Regime Duration	12 506	23,44	18,10	0,00	115,67
Log Econ Democracy	6 953	1,66	0,77	-1,61	2,30
Econ Regime Duration	7 817	59,67	26,54	0	150,00
Log Host War Risk	4 145	0,86	0,65	0	1,95
Log Host Expropriation Risk	3 554	1,01	0,67	0	1,95
Log Host Transfer Risk	4 916	1,26	0,66	0	1,95
Log Geo War Risk	4 598	1,07	0,45	0	1,82
Log Geo Expropriation Risk	4 598	1,18	0,46	0	1,82
Log Geo Transfer Risk	4 598	1,36	0,49	0	1,95
Log Econ War Risk	3 802	0,67	0,34	0	1,61
Log Econ Expropriation Risk	3 802	0,78	0,37	0	1,72
Log Econ Transfer Risk	3 802	0,71	0,39	0	1,76

As observed, no incongruencies are found in the main descriptive statistics of the utilized covariates. An exception being the maximum value of the *GDP Deflator* variable, which presents a robust outlier in the sample. Nevertheless, this observation was kept as the value represented a real annual GDP deflator level for an individual nation.

In Table II of the Appendix, we see the correlation matrix between all the employed variables. At a first glance, no signs of multicollinearity seem to be present between the variables. Nevertheless, between country risk ratings, we observe some high correlations, hence we should be mindful of this fact during our analysis.

Methodology

In order to pursue our econometrics formulation of the research questions we have built, we deployed the Hausman test for endogeneity (Hausman, 1978) to decide if we should pursue a fixed effects or a random effects model in our analysis. As shown in Table III and IV, we clearly reject the null hypothesis of the test that a random effects model is preferred, hence we pursued the fixed model as our choice and built both our analyses in accordance with its specifications.

The two deployed models differ only in the measurement that is taken to account for political risk. The first model utilizes democracy levels as a proxy of political risk, while the second employs export credit country risk ratings broken down in their three subcomponents: a) War and Political Violence Risk, b) Expropriation and Breach of Contract Risk, and c) Transfer Risk.

1. Model Specificities

The specificities of both models come as follows:

1.1. Democracy as a Proxy Model

The following model will be used to empirically test the relationship between democracy and FDI net inflows:

$$LFDI_{host,j} = \alpha_i + \delta CV_{host,j} + \beta_1 LDemocracy_{host,j} + \beta_2 RegimeDuration_{host,j} + \beta_3 LDemocracy_{geo\_neighbourgs,j} + \beta_4 RegimeDuration_{geo\_neighbourgs,j} + \beta_5 LDemocracy_{econ\_neighbours,j} + \beta_6 RegimeDuration_{econ\_neighbours,j} + \varepsilon_{host,j} \quad (1)$$

Where the dependent variable, $LFDI_{host,j}$, is the logarithm of FDI net inflows in the host country at time j, α_i is a common fixed effect term, $CV_{host,j}$ is a vector of the control variables which we will utilize, $LDemocracy_{host,j}$ is the logarithm of democracy levels in the host country at time j, $RegimeDuration_{host,j}$ corresponds to the duration, in years, since the most

recent regime change in the host country at time j, $LDemocracy_{geo\_neighbourgs,j}$ corresponds to the logarithm of average democracy levels of the closest 5 geographical neighbours of the host country at time j, $RegimeDuration_{geo\_neighbourgs,j}$ corresponds to the average duration, in years, since the most recent regime change in the closest 5 geographical neighbours of the host country at time j, $LDemocracy_{econ\_neighbourgs,j}$ corresponds is the logarithm of average democracy levels of the closest 5 economic neighbours of the host country at time j and $RegimeDuration_{econ\_neighbourgs,j}$ corresponds to the average duration, in years, since the most recent regime change in the closest 5 economic neighbours of the host country at time j, and lastly $\varepsilon_{host,j}$ corresponds to the disturbance term.

1.2. Export Credit Country Risk Ratings as a Proxy Model

The following model will be used to empirically test the relationship between export credit country risk ratings with FDI inflows:

$$\begin{aligned} LFDI_{host,j} = {} & \alpha_i + \delta CV_{host,j} + \beta_1 LWar_{host,j} + \beta_2 LExpropriation_{host,j} \\ & + \beta_3 LTransfer_{host,j} + \beta_4 LWar_{geo\_neighbour,j} \\ & + \beta_5 LExpropriation_{geo\_neighbour,j} + \beta_6 LTransfer_{geo\_neighbour,j} \\ & + \beta_7 LWar_{econ\_neighbour,j} + \beta_8 LExpropriation_{econ\_neighbour,j} \\ & + \beta_9 LTransfer_{econ\_neighbour,j} + \varepsilon_{host,j} \end{aligned} \quad (2)$$

Where the dependent variable, $LFDI_{host,j}$, is the logarithm of FDI net inflows in the host country at time j, α_i is a common fixed effect term, $CV_{i,j}$ is a vector of the control variables which we will utilize, $LWar_{host,j}$ correspond to the logarithm of the War and Political Violence risk of the host country at time j, $LExpropriation_{host,j}$ correspond to the logarithm of the Expropriation and Contract Breach risk of the host country at time j, $LTransfer_{host,j}$ correspond to the logarithm of the Transfer risk of the host country at time j. For both

geographical and economic neighbours, the same risks are incorporated in the model, taking their natural log, and so forth.

2. Initial Model Assessment

2.1. Democracy as a Proxy Model

After running the democracy-based model, we obtained very interesting results, with the majority of the explanatory variables of FDI inflows being in accordance with our expectations and statistically significant, while the model seemed to be getting more robust with R Squared increasing from 0.521 in the baseline model (Model 1) to 0.638 in the full model (Model 5) which includes both host, and its' geographical and economic neighbouring democracy levels as explanatory variables. Nevertheless, to further study the model results, we first tested the presence of autocorrelation and heteroskedasticity issues that may be present in it. To study the presence of heteroskedasticity in the model, we employed a modified Wald statistic test for groupwise heteroskedasticity under the null hypothesis of homoscedasticity. As shown in Table III, we reject the null hypothesis of the test, hence concluding that heteroskedasticity is an issue of the calculated model that needs to be dealt with. Regarding autocorrelation, we deployed Wooldridge's test for serial correlation in panel-data models under the null hypothesis that the residuals from the regression of the first-differenced variables should have an autocorrelation of -0.5. Looking at the results of the test presented in Table III, we clearly see that the null hypothesis is rejected, leaving us to conclude that autocorrelation is also a limitation of the model that needs to be dealt with.

To account for both of these issues, we decide to employ in our model clustered standard errors which are robust against both the heteroskedasticity and autocorrelation issues that the model faces. Hence, all the results presented in section 5 – Main Findings - will be in accordance with this new improved and robust model.

2.2. Export Credit Country Risk Ratings as a Proxy Model

The first run of the second model employing Export Credit Country Risk Ratings as a proxy of political risk also presented very interesting results, with several explanatory variables going in accordance to our expectations, with the most notable exceptions being *Log Host Transfer Risk* which presents a statistically significant at the 0.1% level positive relationship with the dependent variable, Log Host FDI Inflows, hinting that a higher risk that investors cannot access their capital in the host country is associated with higher host FDI net inflows.

Furthermore, looking at the models' R Square we see that it decreases by more than 50% from the base model (Model 1) which employed an R Square of 0.521 to the 0.252 seen in the full model (Model 5) which includes all the different country risk ratings for both the host and its' geographical and economic neighbouring nations.

Nevertheless, to analyse in detail the model, we will just like previously, test for the existence of heteroskedasticity and autocorrelation issues. Again, after employing the modified Wald statistic test for groupwise heteroskedasticity (Table IV), we reject the null hypothesis, concluding that heteroskedasticity is also an issue that needs to be dealt with in the model. Lastly, regarding autocorrelation, deploying Wooldridge's test for serial correlation in panel data, we also reject its null hypothesis (Table IV), concluding that just like in the first model, autocorrelation is a limitation that will need to be accounted for.

To deal with both issues, we will also redeploy the model using clustered standard errors, highly robust against both heteroskedasticity and autocorrelation.

3. Sargan-Hansen Test – Fixed Effects vs Random Effects

After including cluster standard errors in both models, we employed the Sargan-Hansen statistical test in order to compare again whether fixed effects or the random effects model was preferable. As shown in Table III and IV we reject the null hypothesis that random effects is preferable, hence we continue to formulate our econometric models using fixed effects.

Main Findings

1. *Democracy as a Measure of Political Risk Model Results*

Dependent Variable = Log FDI Net Inflows					
	Model 1: Baseline Model	Model 2: Host Democracy	Model 3: Host + Geo Neighbours	Model 4: Host + Econ Neighbours	Model 5: Host + Geo + Econ Neighbours
Log GDP Per Capita	1.678***	1.491***	1.613***	1.561***	1.607***
	(0.0583)	(0.150)	(0.193)	(0.163)	(0.205)
GDP Annual Growth	0.0236**	0.0318***	0.0238*	0.0291**	0.0201*
	(0.00764)	(0.00813)	(0.00918)	(0.00954)	(0.00965)
Annual GDP Deflator	-0.000450***	-0.000221***	-0.000231***	-0.000210***	-0.000224***
	(0.000104)	(0.0000506)	(0.0000461)	(0.0000482)	(0.0000390)
Trade to GDP	0.00864***	0.00992+	0.00919*	0.00729*	0.00953*
	(0.00175)	(0.00516)	(0.00409)	(0.00342)	(0.00421)
Population Growth	-0.0444	-0.119	-0.437**	-0.299+	-0.416*
	(0.0523)	(0.171)	(0.159)	(0.150)	(0.166)
Log Host Democracy		0.484*	0.359	0.439*	0.302
		(0.210)	(0.225)	(0.204)	(0.217)
Host Regime Duration		0.0185+	0.0133	0.0153	0.0109
		(0.0110)	(0.0104)	(0.0114)	(0.0122)
Log Geo N. Democracy			0.162		0.169
			(0.148)		(0.160)
Geo N. Regime Duration			-0.0257*		-0.0231
			(0.0124)		(0.0145)
Log Econ N. Democracy				0.0783	0.0879
				(0.0561)	(0.0587)
Econ N. Regime Duration				0.000452	0.000598
				(0.00235)	(0.00206)
Constant	-10.30***	-10.36***	-9.931***	-10.43***	-10.00***
	(0.475)	(1.200)	(1.210)	(1.214)	(1.278)
R-sq	0.521	0.649	0.672	0.635	0.639
Sargan-Hansen Test	78.52 (5)	49.21 (7)	49.50(9)	44.05 (9)	37.97 (11)
Number of Observations	6123	1540	1055	1262	936
Number of Countries	178	55	44	54	44

Notes: Standard errors in parentheses expect on the tests rows, where it corresponds to the degree of freedom of the respective distribution. "N." denotes "Neighbour(s)".

*+ p<0.10 * p<0.05 ** p<0.01 *** p<0.001*

At a first sight, looking at the R Squared improvement of the model with the gradual addition of explanatory variables, coming from 0.521 in the base model to 0.639 in the full model including both the host's democracy levels and the one of its geographical and economic neighbours, we see that the strength of the relationship between our overall model and the

dependent variable *Log FDI Net Inflows* vastly improved, with the full model explaining 63.9% of the dependents' variance.

Furthermore, analysing the individual explanatory variables employed in the model, starting with the control variables, we obtained results in accordance with our exceptions. All control variables employed in the full model are statistically significant at the 5% level, with *Log GDP Per Capita* and *Annual GDP Deflator* being significant at the 0.1% level.

The relationship of the control variables on *Log FDI Net Inflows* comes as expected, following not only economic theory, but also the literature. *Log GDP Per Capita*, measuring market size, is positively related with FDI net inflows as naturally, the bigger the host market, the more operational and strategic space firms have to explore (Jensen, 2006). *GDP Annual Growth* is also positively associated with higher FDI net flows as it is deployed in the model as a measure of economic growth which often translates into higher return of investment (Busse and Hfeker, 2007). *Annual GDP Deflator*, following our expectations, has a negative relationship with the dependent variable, allowing us to support our view that higher host inflation levels, as a measurement of the quality of host macroeconomic policies, is associated with lower host FDI net inflows. *Trade to GDP*, statistically significant at the 5% level, also supports our view that higher trade openness, even though not benefiting horizontal FDI inflows, overall, is associated with higher levels of FDI net inflows. Nevertheless, *Population Growth*, which we expected to have a positive relationship with FDI net inflows, as a higher population growth, with all being equal, results in bigger markets, which in turn generates higher returns on investment.

However, looking at the relationship between host democracy levels and its regime duration, the full model does not find a statistically significant relationship. In accordance with our expectation, both *Log Host Democracy* and *Host Regime Duration*, would be positively associated with host FDI net inflows, but although the sign of both coefficients is positive in the fill model, we did not manage to find statistical evidence that they were positively

associated. The same goes for the relationship found between geographical and economic neighbouring democracy levels and regime duration. Even though their coefficient, excluding *Geographical Neighbouring Regime Duration*, matches our positive expectations, we did not manage to find statistical inference that they are associated with host FDI net inflows.

It is worth noting that in model 2) when only accounting for the hosts' democracy levels and regime duration, both are statistically significant at the 5% level, being positively associated with host FDI net inflows. The same in model 4) where higher host democracy levels are statistically significant at the 5% level associated with higher host FDI net inflows, and lastly, in model 3), we find statistically evidence at the 5% levels that the higher averages of geographical neighbouring regime duration is associated with lower host FDI net inflows.

2. *Export Credit Country Risk Ratings as a Proxy Model Results*

Dependent Variable = Log FDI Net Inflows					
	Model 1: Baseline Model	Model 2: Host Democracy	Model 3: Host + Geo Neighbours	Model 4: Host + Econ Neighbours	Model 5: Host + Geo + Econ Neighbours
Log GDP Per Capita	1.678***	1.150***	1.121***	1.097***	1.097***
	(0.0583)	(0.0881)	(0.0949)	(0.100)	(0.102)
GDP Annual Growth	0.0236**	0.0197***	0.0178**	0.0196***	0.0180**
	(0.00764)	(0.00572)	(0.00573)	(0.00576)	(0.00578)
Annual GDP Deflator	-0.000450***	0.00115	0.00105	0.00112	0.000976
	(0.000104)	(0.000866)	(0.000760)	(0.000913)	(0.000788)
Population Growth	-0.0444	0.0632+	0.0639+	0.0630+	0.0639+
	(0.0523)	(0.0356)	(0.0365)	(0.0373)	(0.0383)
Trade to GDP	0.00864***	0.00749***	0.00745***	0.00751***	0.00749***
	(0.00175)	(0.00187)	(0.00188)	(0.00186)	(0.00187)
Log Host War Risk		-0.171	-0.119	-0.202	-0.136
		(0.144)	(0.151)	(0.150)	(0.155)
Log Host Expropriation Risk		-0.190	-0.240+	-0.189	-0.239+
		(0.121)	(0.128)	(0.121)	(0.128)
Log Host Transfer Risk		0.298*	0.358*	0.283+	0.336*
		(0.148)	(0.150)	(0.146)	(0.147)
Log Geo N. War Risk			-0.0610		-0.124
			(0.259)		(0.264)
Log Geo N. Expropriation Risk			-0.0424		-0.0528
			(0.362)		(0.364)
Log Geo N. Transfer Risk			-1.052*		-1.039*
			(0.465)		(0.460)
Log Econ N. War Risk				0.0694	0.0324
				(0.193)	(0.192)
Log Geo N. Expropriation Risk				0.194	0.156
				(0.179)	(0.181)
Log Econ N. Transfer Risk				-0.131	-0.00666
				(0.168)	(0.165)
Constant	-10.30***	-5.748***	-3.959***	-5.358***	-3.798**
	(0.475)	(0.808)	(1.176)	(0.907)	(1.213)
R-sq	0.521	0.243	0.250	0.244	0.252
Sargan-Hansen Test	78.52 (5)	23.70 (8)	36.32 (11)	25.79 (4)	45.76 (14)
Number of Observations	6123	2677	2586	2661	2586
Number of Countries	178	156	150	155	150

Note: Standard errors in parentheses except in the available tests, where it accounts for the respective degrees of freedom. "N." refers to "Neighbour(s)"
*+ p<0.10 * p<0.05 ** p<0.01 *** p<0.001*

Looking at the evolution of the R Squared indicator of the model when adding increasingly more explanatory variables we see that it's actually goodness-of-fitness dropped significantly from the base model to the full model presented under the column 5) which encompasses not

only the hosts' country risk ratings, but also the ones' of both its geographical and economic neighbours. Going from the baseline model, with just control variables employed in the model, and adding just host country risk ratings into the analysis, we see a drop of more than 50% in the dependent variable variance explained by the model, going from 0.521 to 0.243. After that, adding increasingly more explanatory variables in the analysis increases, only slightly, the goodness-of-fit of the model.

Nevertheless, it is worth taking a closer look at the individual explanatory variables employed in the full model.

Regarding the control variables, similarly to the previous model, all are associated with FDI net inflows, as expected, with an exception being *Annual GDP Deflator*, which is not found to be statistically significantly associated with the dependent variable. As opposed to the previous model, nonetheless, higher Host Population Growth is statistically significantly associated at the 5% level with higher host FDI net inflows, as we had argued for.

Furthermore**,** in accordance with our expectation *Log Host Expropriation Risk* has a negative relationship with host FDI net inflows. This is a rather interesting finding, which is heavily supported in the literature. Jensen, 2008, argues that from the three different risks that foreign investment insurers focus on, expropriation risk remains the one with most demand from investors. For instance, from 1991 to 2004, 84% of the settlement amounts of OPIC claims, the public U.S. foreign investment insurer, were related directly or indirectly with the expropriation of assets, whether tangible or intangible, in foreign markets (O'Sullivan, 2005, 31).

Still focusing on the hosts' country risks, opposed to our expectation, we see a statistically significant positive relationship at the 5% level between *Log Host Transfer Risk* and hist FDI net inflows. This finding is rather surprising because it goes against the literature and economic theory. With an increase in transfer risk in the host country, foreign capital increasingly finds more barriers to move around in the host nation, but also if it wants to get out of it. A risk that

can be elevated during a financial crisis when liquidity decreases. Therefore, we would expect profit-maximising multinational companies, all else equal, to prefer investing in markets with lower transfer risk. Nevertheless, the statistically significant relationship found between this host risk and host FDI net inflows can be a gateway to further research on the topic.

Furthermore, in accordance with the just laid out argument and expectation, we find statistical evidence at the 5% level that higher geographical neighbours' transfer risk is associated with lower host FDI net inflows. This finding supports the long-established agreement between scholars that across geographical neighbouring countries there is a contagious effect of institutional quality and governance ideals (see for example Kelejian et al., 2013, and Bosker & Garretsen, 2009).

Although we did not manage to find statistical evidence of several of the relationships between host FDI net inflows and both the hosts' and its neighbouring countries' risk ratings, for reasons we will discuss in the next section, we believe our full model provides a great starting point for further research on the topic.

Limitations

The lack of empirical findings in both our models can be attributed to many reasons, below we list the main ones:

1. Endogeneity and autocorrelation

As laid out by Busse and Hekefer (2007), endogeneity plays an important role when modelling FDI inflows. For instance, GDP per capita, measuring market size, can influence FDI inflows, but the contrary is also true. The authors also explore the issue of autocorrelation when dealing with the econometric problem of modelling FDI inflows, concluding that to account for both endogeneity and autocorrelation issues in the data, a lagged dependent variable, this is, lagged FDI inflows, should be added on the right side of the equation, transforming past FDI flows, a determinant of future inflows, something that does not go against economic theory as past inflows of FDI are also determinants of future flows.

Therefore, moving from a fixed effects model, the authors defend that employing a dynamic panel model, like the one introduced by Arellano and Bond (1991) – the GMM estimator - would perform better, be more robust and ultimately yield better results.

2. FDI Fluctuations

Furthermore, FDI is also prone to significant fluctuations, especially in smaller countries where single inflows can have a significant impact in the aggregate value, increasing its variance, and decreasing the robustness of the deployed econometrics model.

3. Political Risk Measurement Issues

There is not a consensus on how political risk should be measured. As a multidimensional variable, depending on how political risk is measured, different results can arise from its relationship with FDI inflows. With growing academic interest, novel ways to quantify political risk are constantly appearing, and with FDI location decisions becoming increasingly more driven by political aspects, more robust measurement of political risk should be deployed.

Conclusion

Throughout the last fifty years globalization has been a key pillar of macroeconomic policy theory across the five continents, pushing nations across the world to become increasingly more interdependent and connected. FDI played a crucial role in the development of these economic dynamics, allowing investors to allocate capital in foreign markets, bringing long-term benefits for both the investments' host economy and for the foreign investor. Due to its economic importance and relevance, it is of great interest not only academically, but also policy wise to study the determinants of FDI flows in light of current economic, social and political scenarios. Observing an increase in political polarization throughout the globe, ranging from the U.S, Europe, and Russia, we explore the effects of political risk in the attractiveness of individual nations regarding FDI inflows. Besides exploring the relationship between host country political risk characteristics with the FDI inflow amount it attracts, we expand the study to both the host's geographical and economic neighbours political risk effects.

Employing two different econometric models in our analysis, we conclude that, all else equal, countries with higher expropriation risk, i.e., the risk that assets held in its jurisdiction are expropriated from the rightful owners, observe lower levels of FDI inflows. The same negative relationship is statistically found regarding the transfer risk of the host's closest geographical neighbours and the FDI inflow levels that it attracts, i.e., host countries with geographical neighbours possessing higher transfer risk – the risk that capital cannot freely move throughout the economic agents inside the nation – observe lower FDI inflows. Our findings support the spillover effect of economic conditions between neighbouring economic players formulated in past literature.

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Appendix

Table I – Variable Description

Variable	Definition	Measure	Source
FDI Net Inflows Per Capita	Measures new foreign direct investments minus disinvestment, per capita, in order to account for the relative size of the country	Current USD	UNCTAD Balance of Payments Database
GDP Per Capita	Gross domestic product cer capita measures the relative size of the economy	Current USD	World Bank World Development Indicators Database
GDP Growth	Measures the annual gross domestic product growth of the economy	% (absolute)	World Bank World Development Indicators Database
GDP Deflator (Inflation)	Measures the annual inflation level of a country	% (absolute)	World Bank World Development Indicators Database
Population Growth	Measures the annual growth of the population	% (absolute)	World Bank World Development Indicators Database
Trade to GDP	Measures the sum of exports and imports of goods and services measured as a share of gross domestic product.	% (absolute)	World Bank World Development Indicators Database
Democracy	Polity II Index characterises a government in a scale from -10 (fully authoritarian) to 10 (fully democratic)	Custom Scale (-10 to 10)	Polity IV Project, Political Regime Characteristics and Transitions, 1800–2018
Regime Duration	Measure the number of years without a regime change in the country in question	Years	Polity IV Project, Political Regime Characteristics and Transitions, 1800–2018
War and Political Violence Risk	Associated with the direct or indirect impact of political violence caracterized by disrupting the firm's market, assets or operations.	Custom Scale (1 - 7)	Belgium Export Credit Agency
Expropriation/Breach of Contract	Covers the risk of expropriation of assets along with unexpected breach of signed contracts between the firm and a third party	Custom Scale (1 - 7)	Belgium Export Credit Agency
Transfer Risk	Comprises the risk of foreign entities restricting or blocking capital flow between borders and institutions	Custom Scale (1 - 7)	Belgium Export Credit Agency

Table II – Correlation Matrix

	Log FDI per Capita	Log GDP per Capita	GDP Growth	GDP Deflator	Population Growth	Trade to GDP	Log Host Democracy	Host Regime Duration	Log Geo Democracy	Geo Regime Duration	Log Econ Democracy	Econ Regime Duration	Log Host War Risk	Log Host Expropriation Risk	Log Host Transfer Risk	Log Geo War Risk	Log Geo Expropriation Risk	Log Geo Transfer Risk	Log Econ War Risk	Log Econ Expropriation Risk	Log Econ Transfer Risk
Log FDI per Capita	1																				
Log GDP per Capita	.830	1																			
GDP Growth	-.05	-.22	1																		
GDP Deflator	-.17	-.17	.078	1																	
Population Growth	-.28	-.38	.176	.049	1																
Trade to GDP	.450	.206	.036	-.10	-.00	1															
Log Host Democracy	.412	.423	-.07	-.11	-.38	.127	1														
Host Regime Duration	.477	.653	-.20	-.19	-.14	-.00	.414	1													
Log Geo Democracy	-.04	-.11	-.01	.096	.006	.135	-.12	-.22	1												
Geo Regime Duration	.610	.645	-.18	-.14	-.31	.378	.273	.557	.042	1											
Log Econ Democracy	-.01	-.04	.073	.058	.005	-.03	-.02	-.04	.127	.000	1										
Econ Regime Duration	.261	.231	-.03	.033	.125	.066	.103	.144	-.04	.060	.040	1									
Log Host War Risk	-.62	-.67	.120	.204	.402	-.27	-.64	-.50	.135	-.44	-.05	-.19	1								
Log Host Expropriation Risk	-.65	-.73	.165	.324	.365	-.22	-.62	-.56	.189	-.47	.011	-.15	.818	1							
Log Host Transfer Risk	-.66	-.84	.186	.319	.275	-.19	-.48	-.68	.199	-.55	.028	-.21	.699	.822	1						
Log Geo War Risk	-.47	-.48	.122	.098	.588	-.43	-.33	-.14	-.21	-.43	-.05	.117	.418	.409	.423	1					
Log Geo Expropriation Risk	-.46	-.49	.149	.114	.516	-.50	-.27	-.09	-.27	-.46	.075	.127	.384	.381	.412	.891	1				
Log Geo Transfer Risk	-.65	-.63	.142	.145	.422	-.63	-.29	-.26	-.08	-.54	.035	-.02	.443	.475	.567	.843	.854	1			
Log Econ War Risk	-.36	-.36	.040	-.08	.302	-.23	-.19	-.22	-.09	-.26	-.27	-.26	.406	.376	.415	.429	.373	.389	1		
Log Econ Expropriation Risk	-.38	-.44	.047	.000	.209	-.18	-.09	-.23	-.03	-.33	-.29	-.34	.381	.361	.467	.354	.341	.381	.855	1	
Log Econ Transfer Risk	-.53	-.61	.153	.121	.178	-.22	-.19	-.38	.087	-.43	.016	-.47	.440	.491	.629	.327	.330	.454	.685	.833	1

Table III – Democracy Model with default standard errors

Dependent Variable = Log FDI Net Inflows					
	Model 1: Baseline Model	Model 2: Host Democracy	Model 3: Host + Geo Neighbours	Model 4: Host + Econ Neighbours	Model 5: Host + Geo + Econ Neighbours
Log GDP Per Capita	1.678***	1.491***	1.613***	1.561***	1.607***
	(0.0242)	(0.0629)	(0.0756)	(0.0692)	(0.0816)
GDP Annual Growth	0.0236***	0.0318***	0.0238***	0.0291***	0.0201**
	(0.00303)	(0.00592)	(0.00653)	(0.00621)	(0.00686)
Annual GDP Deflator	-0.000450***	-0.000221***	-0.000231***	-0.000210***	-0.000224***
	(0.0000505)	(0.0000537)	(0.0000471)	(0.0000539)	(0.0000482)
Trade to GDP	0.00864***	0.00992***	0.00919***	0.00729***	0.00953***
	(0.000780)	(0.00170)	(0.00204)	(0.00202)	(0.00217)
Population Growth	-0.0444*	-0.119+	-0.437***	-0.299***	-0.416***
	(0.0200)	(0.0626)	(0.0823)	(0.0759)	(0.0863)
Log Host Democracy		0.484***	0.359***	0.439***	0.302**
		(0.110)	(0.105)	(0.119)	(0.112)
Host Regime Duration		0.0185***	0.0133**	0.0153***	0.0109*
		(0.00414)	(0.00414)	(0.00461)	(0.00456)
Log Geo N. Democracy			0.162*		0.169*
			(0.0652)		(0.0746)
Geo N. Regime Duration			-0.0257***		-0.0231***
			(0.00482)		(0.00554)
Log Econ N. Democracy				0.0783+	0.0879+
				(0.0423)	(0.0455)
Econ N. Regime Duration				0.000452	0.000598
				(0.00149)	(0.00155)
Constant	-10.30***	-10.36***	-9.931***	-10.43***	-10.00***
	(0.193)	(0.496)	(0.605)	(0.566)	(0.661)
R-sq	0.521	0.649	0.672	0.635	0.639
Hausman Test	135.80 (5)	110.69 (7)	102.35 (9)	118.74 (9)	42.70 (11)
Modified Wald Test	82965 (55)	8013.7 (44)	26.3e+3 (54)	2.8e+08 (44)	2.8e+08 (44)
Wooldridge Test	62.17 (174)	23.77 (54)	22.41 (41)	12.36 (51)	17.84 (38)
Number of Observations	6123	1540	1055	1262	936
Number of Countries	178	55	44	54	44

Notes: Standard errors in parentheses expect on the tests' rows, where it corresponds to the degrre of freedom of the respective distribution. "N." denotes "Neighbour(s)".
*+ p<0.10 * p<0.05 ** p<0.01 *** p<0.001*

Table IV – Country Risk Ratings Model with default standard errors

Dependent Variable = Log FDI Net Inflows					
	Model 1: Baseline Model	Model 2: Host Democracy	Model 3: Host + Geo Neighbours	Model 4: Host + Econ Neighbours	Model 5: Host + Geo + Econ Neighbours
Log GDP Per Capita	1.678***	1.150***	1.121***	1.097***	1.097***
	(0.0242)	(0.0448)	(0.0539)	(0.0530)	(0.0576)
GDP Annual Growth	0.0236***	0.0197***	0.0178***	0.0196***	0.0180***
	(0.00303)	(0.00337)	(0.00346)	(0.00341)	(0.00347)
Annual GDP Deflator	-0.000450***	0.00115	0.00105	0.00112	0.000976
	(0.0000505)	(0.000992)	(0.001000)	(0.000993)	(0.00100)
Population Growth	-0.0444*	0.0632**	0.0639**	0.0630**	0.0639**
	(0.0200)	(0.0197)	(0.0198)	(0.0198)	(0.0198)
Trade to GDP	0.00864***	0.00749***	0.00745***	0.00751***	0.00749***
	(0.000780)	(0.00107)	(0.00111)	(0.00108)	(0.00111)
Log Host War Risk		-0.171*	-0.119	-0.202*	-0.136+
		(0.0773)	(0.0796)	(0.0787)	(0.0806)
Log Host Expropriation Risk		-0.190*	-0.240**	-0.189*	-0.239**
		(0.0823)	(0.0840)	(0.0824)	(0.0841)
Log Host Transfer Risk		0.298**	0.358***	0.283**	0.336***
		(0.0965)	(0.0981)	(0.0978)	(0.0991)
Log Geo N. War Risk			-0.0610		-0.124
			(0.170)		(0.179)
Log Geo N. Expropriation Risk			-0.0424		-0.0528
			(0.236)		(0.239)
Log Geo N. Transfer Risk			-1.052***		-1.039***
			(0.241)		(0.248)
Log Econ N. War Risk				0.0694	0.0324
				(0.134)	(0.142)
Log Geo N. Expropriation Risk				0.194	0.156
				(0.147)	(0.150)
Log Econ N. Transfer Risk				-0.131	-0.00666
				(0.116)	(0.121)
Constant	-10.30***	-5.748***	-3.959***	-5.358***	-3.798***
	(0.193)	(0.439)	(0.660)	(0.499)	(0.672)
R-sq	0.521	0.243	0.250	0.244	0.252
Hausman Test	135.80 (5)	35.25 (8)	35.00 (11)	45.44 (11)	40.51 (14)
Modified Wald Test	1.9+e4 (178)	2.8+e4 (156)	2.7+e4 (150)	2.8+e4 (155)	3.1+e4 (150)
Wooldridge Test	62.17 (174)	44.48 (154)	43.01 (148)	44.10 (153)	43.14 (148)
Number of Observations	6123	2677	2586	2661	2586
Number of Countries	178	156	150	155	150

Note: Standard errors in parentheses except in the available tests, where it accounts for the respective degrees of freedom. "N." refers to "Neighbour(s)"
*+ p<0.10 * p<0.05 ** p<0.01 *** p<0.001*